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SUBJECT: IMF RESREP SPEAKS OUT ON SENEGAL'S BUDGET PROBLEMS

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DAKAR 00000661 001.2 OF 003

¶1. (SBU) Summary: During recent press interviews, IMF Resrep Alex Segura underscored growing concerns about Senegal's critical budget deficit. He stated that the deficit (currently estimated at more than USD 300 million) could weaken the economy and speculated that the government could have difficulties paying civil servants' salaries if corrective measures are not taken soon. Segura also publicly highlighted the problem of the GOS's stock of unpaid bills to private suppliers of goods and services. He asserted that these arrears could "destroy" the private sector. In response, Prime Minister Soumare convened a special cabinet meeting on May 16 to address the country's public finances. The same day, the Finance Minister described the financial situation as "difficult but manageable" and said concrete steps would be taken to bring public spending back in line. He also announced plans for issuing approximately USD 260 million in treasury bonds to pay the government debt. End Summary.

IMF RESREP OUTSPOKEN ON BUDGET DEFICIT

¶2. (U) In an interview published May 16 by the daily "le Quotidien," IMF Resident Representative Alex Segura made an unusual public critique of Senegal's public finances, pointing out that the budget is in serious deficit. He claimed that Senegal could face severe difficulties in paying civil servant salaries and meeting other financial obligations in the coming months if no drastic measures are taken. Segura pointed to GOS subsidies as the main culprit in the budget deficit, especially those targeting energy and food. He added that the budget deficit is especially difficult because of the GOS's surprising accumulation of unpaid bills owed to the private sector, which amount to an estimated CFA 150 billion (USD 357 million). Senegal's Policy Support Instrument (PSI) with the IMF caps such arrears at CFA 30 billion (USD 71 million). Segura's critique was direct: "The accumulation of unpaid bills to the private sector is a clear indication that Senegal is not capable of supporting its current level of spending. It is therefore sacrificing the growth of its private sector in exchange for the expansion of subsidies."

¶3. (U) Regarding subsidies, Segura was equally blunt: "This is unacceptable and unsupportable." He noted that the recent elimination of customs duties and VAT on certain imported food items (especially rice), as well as longstanding subsidies on cooking gas and electricity, cost the budget much as CFA 200 billion, which is equal to 3.5 percent of GDP.

¶4. (SBU) Segura also blamed extra-budgetary spending as another key factor in Senegal's current budget crisis. A number of Ministries have signed contracts or taken on other funding obligations not

previewed in the budget and without the approval of the Ministry of Finance. We have learned from our sources that the biggest perpetrators have been the Ministry of Infrastructure, with more than CFA 70 billion (USD 166 million, largely for contracts over the past two years to support last March's Dakar Summit of the Organization of Islamic States), and the Ministry of Interior (for programs also related to the OIC summit as well as the 2007 presidential and legislative elections), and the Presidency with an estimated CFA 2 billion (USD 4.7 million). The President frequently travels - at least twice a month - accompanied by staff members in a leased aircraft.

¶5. (U) Segura urged the government to implement "courageous and effective" measures to face its budget deficit and restore macroeconomic stability. Segura's proposals include a combination of a CFA 20 billion (USD 47 million) cut on the operating budget and CFA 70 billion (USD 166 million) cut on the investment budget, representing eleven percent of the FY08 operating budget and 5 percent of total expenditures. He warned that the IMF "won't support a country with a huge budget deficit, a high level of unpaid bills to private suppliers, and a lack of commitment . . . to stabilize the macroeconomic situation."

¶6. (U) In his May 16 interview and subsequent public statements, Segura underscored his support for the Minister of Finance, Abdoulaye Diop: "Minister Diop did not create this situation; he has our support and that of many donors," said Segura. He recommended that Diop be given full authority to take corrective measures and to monitor Senegal's financial commitments and expenditures.

GOS CRITICISM BUT ALSO ACTION

¶7. (SBU) The government's initial reaction to Segura's public scolding was defensive. "We know that the budget situation is critical, we understand that the unpaid bills to the private sector

are problematic, but Segura has challenged our credibility by releasing the content of a working document - not yet completed - to the press," commented a senior official from the Finance Ministry. The tone was more "virulent" among the ruling PDS party supporters and some senior officials from the Ministry of Finance who asked the Government to consider Segura as "persona non grata" for trying to "set fire" to the country. According to one contact, Prime Minister Soumare was so upset he wanted to take action to "PNG" Segura, but he soon backed off that idea.

¶8. (U) In reaction to Segura's interview, Prime Minister Soumare held an emergency cabinet meeting on the afternoon of May 16 to reassure the Senegalese on the budget situation. Deputy Minister of Finance in Charge of the Budget, Ibrahima Sarr, and his senior staff members along with Segura attended the meeting. In a press conference following the emergency meeting, Deputy Minister Sarr adopted an optimistic view and noted, "we have no problem in meeting our financial obligations to pay the salaries of our civil servants. I think our current situation is under control and we can stop the 'fire' anytime." Segura reiterated his earlier remarks, stating, "I confirm that the budgetary situation is critical and alarming."

¶9. (U) On May 22, the Prime Minister signed an administrative note to urge all the Ministries -- except for the Ministries of Health, Education, and Water -- to significantly reduce their level of spending on goods and services (from their FY08 operational budgets) and also limit their investment budgets in an effort to meet the CFA 70 billion in cuts proposed by Segura. The PM also reiterated the primacy of the Finance Ministry for controlling expenditures, and the need to pay all expenditure obligations in a timely manner.

DEBT FOR BILLS

¶10. (U) Shortly after Segura's press statements, MinFin Diop confirmed the existence of budget difficulties but stressed that Senegal has several tools and measures to bring the situation under control. He downplayed any perceived tension with the IMF: "our relations with the IMF are excellent and based on trust and mutual understanding." Diop also announced plans to issue new treasury

bonds worth CFA 110.8 billion (USD 264 million) before September. These issuances, reportedly with around 30 percent as treasury bills targeting the regional CFA zone, and 70 percent as government bonds targeting local banks, apparently have been given the green light by the IMF and will be used to pay off the government's arrears. Diop also made a point of allaying fears about nonpayment of civil servant salaries. He noted monthly fiscal revenues of CFA 90 billion (USD 214 million) are sufficient to cover the country's monthly wage bills of CFA 28 billion.

¶11. (SBU) In a June 4 meeting with the Charge, Budget Minister Sarr claimed the first issuance would take place before June 20. He also claimed that CFA 70-80 billion would be sufficient to cover the arrears, leaving CFA 30-40 billion as a "cushion" for the treasury. Even with the new debt financing, Senegal's budget relies on donor budget support of CFA 102 billion (USD 243 million), and this money is not yet forthcoming. According to Sarr, he is pleading with the World Bank, the EU, and France to speed up disbursement of their pledged budget support.

CONCERN ABOUT SUBSIDIES

¶12. (U) Segura also raised his concern about "routine" government subsidies for certain food items, cooking gas, and electricity, which could cost the government a combined CFA 170 billion in 2008. With the newer subsidies on rice the total could reach CFA 200 billion (USD 476 million). The budget is also impacted by the recent suspension of duty and VAT on rice and other items. Segura asserted these measures produce little benefit for truly poor households (who already can't afford such items), but and have created a major disequilibrium in public finances. Segura, as well as the broader donor community, has pointed out that despite these subsidies and other protections, Senegal generally pays more for electricity, gasoline, rice, milk, sugar, and cooking oil than many of the other countries in the sub-region.

REACTION

¶13. (SBU) The IMF Resrep was aware that his interview would raise the hackles of the government (he granted it to one of the most consistently anti-government dailies). Segura told Econ Counselor that he did so with the support of IMF headquarters as an admittedly attention-grabbing measure to highlight the need for swift GOS measures to address the looming budget crisis. There were serious calls by PDS officials and some in government to "kick out" the Resrep, but calmer heads prevailed - with the understanding that

donors largely approved of Segura's actions. Many officials at the Ministry of Finance were privately pleased by Segura's actions, which should help bring expenditures mostly back under their control. One senior MOF official said, "it had to be done." Hundreds of businesses waiting to be paid are undoubtedly also appreciative of this public challenge to an untenable situation.

COMMENT

¶14. (SBU) Segura's interview was a necessary exercise to force the government's hand on the budget deficit, reimburse unpaid bills, and pursue economic reforms within the PSI program. However, the government did not turn over easily and it is not assured that this marks the beginning of a new commitment by the Wade political machine to assure sound fiscal management is a top priority. We heard that officials from the Budget Ministry tried to undermine the government's commitment to immediate budget cuts, first by trying to target health and education spending (and perhaps foist the blame on the IMF), and then by substituting a different document at the last minute, apparently hoping the IMF would not go through with its threat to suspend its program. Fortunately, the IMF stuck to its guns and, we hope, real budget discipline will follow. The IMF is not blameless in this saga. The accumulation of unpaid bills was widely known, and the IMF failed to fully follow the trail last fall when it gave the GOS a pass on that prior action (Reftels). When the full scope of the problem came to light, the IMF had to rescue its own reputation, not just companies in the long payment queue.